SFA BILL ANALYSIS

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House Bill 4466 (as enrolled) **PUBLIC ACT 194 of 1989**
House Bill 4433 (as enrolled) **PUBLIC ACT 193 of 1989**
Sponsor: Representative Wilfred Webb (H.B. 4466)
Representative Justine Barns (H.B. 4433)
House Committee: Senior Citizens and Retirement
Senate Committee: Judiciary

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RATIONALE

Although the Public School Employees Retirement Act was virtually overhauled by Public Act 91 of 1985, there are a number of issues that many believe should now be addressed, particularly issues that relate to the purchase of service credit by members of the public school employees retirement system (PSERS), members' participation in the Member Investment Plan, the lack of system-provided dental, vision, and hearing benefits for retirants and their beneficiaries, and the reduction of retirees' purchasing power due to inflation. These concerns are discussed in more detail below.

Purchase of Service Credit

The Act allows members, under certain circumstrances, to purchase service credit for various types of public employment or for periods of time that cause interruptions or delays in public school employment. Members may purchase service credit for time spent in the military, parental leave, employment with the Federal government, out-of-system public education employment, and sabbatical leave, for example. The formula used to compute members' contribution varies from option to option, but generally members must pay, for each year purchased, an amount equal to a certain percentage of a member's full-time compensation for the school fiscal year in which payment is made, or an amount equal to the amount the member would have contributed under a member contribution schedule. For purposes of computing payment, the Act specifies that the contribution amount cannot be less than the highest school year compensation previously received by the member.

Apparently, these formulas have caused problems concerning compensation unique to the teaching profession. School teachers can elect to receive their annual salary at 12 regular pay periods throughout the year, or during the 10-month school year, in which case they receive their summer pay in a lump sum at the beginning of the summer break. When members have gone from a 12-month pay period in one school year to a 10-month pay period in the next, however, a member actually may receive 14 months' salary in one year. This exaggerated salary figure has been used, according to some members, to calculate the amount they must pay to purchase service credit. Reportedly, the retirement system has interpreted the Act to mean that the compensation amount used to compute service credit payment must include all income received in a school fiscal year, regardless of when it was earned, and this interpretation has been upheld by a 1988 Opinion of the Attorney General (OAG No. 6503). Some people believe that this is an inequity that should be corrected.

In addition, it has been suggested a nonspecific service credit provision should replace most of the 27 different types of service for which credit currently may be purchased. Reportedly, the law promotes a perception that the retirement system is elitist, because the current types of service are used primarily by teaching employees. Further, although additional types of service traditionally have been recognized in response to conditions affecting significant portions of the employee population, the more recent trend has been to allow buy-ins for many other types of service that have only limited application. Also, it is reported that the diverse buy-in provisions have bogged down the retirement system in its efforts to educate members and process service credit purchases.

Member Investment Plan

Until 1985, post-retirement increases were made only sporadically. Among the 1985 amendments was the creation of the Member Investment Plan (MIP), which was designed to provide members with reliable cost-of-living increases. Members of the system can make a one-time choice between the MIP and the basic plan. The MIP is funded by employee contributions at a rate of 4% of their annual compensation, although that rate is to be adjusted every three years to equal the percentage needed to fund MIP benefits. Although the two plans have benefits in common--including health insurance for retirants and eligible dependents, duty death benefits, duty and nonduty disability benefits, provision for deferred retirement, and provision for reduced retirement--the MIP offers enhanced benefits, which include earlier retirement, larger monthly checks, a yearly increase to help counter inflation, and earlier survivor protection.

The retirement system reports, though, that the MIP was selected by only 52% of the employees required to choose between the plans by the end of 1986, and participation in the MIP by new members has been a disappointing 31%, while the 4% contribution rate was based upon 100% participation according to the actuarial study that preceded the plan's creation. Further, some people believe that an inequity exists in the plan's funding. That is, because Public Act 91 of 1985 provided for enhanced benefits for all employees who choose the MIP and then retire, even if they retire only one year later, current and future MIP participants are paying for the enhanced benefits for those retirees as well as for themselves. The retirement system also cites the frustration and anger of employees who have chosen the basic plan through ignorance, indifference, or uncertainty, and then find themselves unable to change plans; the difficulty of educating 40,000 new employees annually about the plans; and the need of future retirees to obtain more and more of their retirement income from sources other than Social Security.

Dental, Vision, and Hearing Benefits

Although Public Act 91 extended to retired school employees many of the benefits enjoyed by retired State employees, the PSERS does not pay for dental, vision, and hearing benefits or offer those benefits at the retiree's own cost. When employees move from active employment with full benefits to retirement, they often suffer a reduction in benefits due to this lack, and many older retirees, especially those who have been retired for some time, report that dental, vision, and hearing care expenses take up an unreasonably large portion of their income.

CONTENT

House Bill 4466 would amend the Public School Employees Retirement Act to make the following changes, among many others, concerning the PSERS:

-- **Require new members of the system to contribute to the Member Investment Plan; include a range of contribution rates based on annual compensation for new members; lower the contribution rate to 3.9% for current members; and allow members to discontinue MIP contributions.**
-- **Include nonspecific provisions allowing the purchase of service credit for up to five years at actuarial cost, and set a January 31, 1991, deadline on the purchase of service credit for certain employment (e.g., with the Red Cross, the National Guard, or a**

county mental health program).

- **Provide for an increase based on a percentage of a retirement allowance; and retain the 3% annual increase.**

House Bill 4433 would amend the Act to require the system to pay 90% of the monthly premium or membership or subscription fee for dental, vision, and hearing benefits for a retirant or retirement allowance beneficiary who elected coverage in the plan authorized by the Retirement Board and the Department, and for each health insurance dependent of a retirant receiving those benefits.

House Bill 4433 is tie-barred to House Bill 4466. A description of House Bill 4466 follows.

Member Investment Plan

The bill would delete the provision that sets the MIP contribution rate at 4% of a member's annual compensation, and requirement that the percentage to be adjusted every three years beginning October 1, 1990. Under the bill, until December 31, 1989, the contribution rate would be 4% for a person who first became a member on or before that date, and who elected on or before that date to contribute to the MIP. Beginning January 1, 1990, the person's rate would be 3.9%.

A person who first became a member on or after January 1, 1990, would have to contribute the amounts listed below based on the member's annual school fiscal year earned compensation. (These rates also would apply to a person who first became a member on or before December 31, 1986, but did not perform membership service between that date and January 1, 1990, and returned to membership service on or after January 1, 1990.)

Compensation	Contribution to MIP
Not over $5,000	3% of member's compensation
Over $5,000 but not over $15,000	$150 + 3.6% of excess over $5,000
Over $15,000	$510 + 4.3% of excess over $15,000

A member who was subject to these rates could elect irrevocably to discontinue contributions to the MIP after the end of three school fiscal years following the date he or she first contributed to the MIP, but could not discontinue more than four school fiscal years following the date of the first contribution. The member would receive a refund of MIP contributions plus interest, as determined by the Retirement Board, payable within six months after the date of notification by the reporting unit. The member would not be entitled to the benefits afforded MIP members. A member who contributed to the MIP would have to be given advance written notice of his or her opportunity to elect to discontinue MIP contributions. The subsection of the bill containing these provisions would not apply until the Department received notice from the Internal Revenue Service that the subsection would not disqualify the retirement system for tax purposes under the Internal Revenue Code.

Purchase of Service Credit

The bill provides that a member could elect to purchase up to five years of service credit, minus the years of service credit purchased under the current Act, upon request and payment to the retirement system of the actuarial cost. Purchased service credit could not be used to satisfy the minimum of 10 years of service credit required to receive a retirement allowance under the Act, or to satisfy the service credit requirements for a retirement allowance paid before age 46.

The bill provides for the repeal as of January 31, 1991, of sections of the Act that allow the purchase of service credit for teaching non-U.S. citizens in a foreign country or teaching with the merchant marines, employment with a county mental health program, working for the American Red Cross, duty with the Michigan National Guard or the U.S. armed forces reserve, service with VISTA or the Peace Corps, and employment with a municipal recreation department. The bill also would put a deadline of January 31, 1991, on service for which credit may be purchased by a person for teaching at a military base, in a foreign school for U.S. personnel or dependents, with the job corps, in a trust territory, or on an Indian reservation, or for out-of-system public education service performed while the person was a full-time student, or by a person who was excluded from membership but later becomes a member. In addition, the bill would repeal a section requiring service credit to be granted for a member who was granted a duty disability retirement allowance and returns to service (which is covered in another section of the Act).

Under the bill, credit both for specific service and for the proposed generic five years would be purchased at actuarial cost. (The cost of purchasing credit for military service and "out of system" public education service, however, would remain at the current rates.) Actuarial cost would be equal to the product of the following:

-- A percentage, determined by the retirement board and the Department of Management and Budget, that when multiplied by a member's compensation, as determined below, resulted in the average actuarial present value of the additional benefits resulting from the crediting of one additional year of service. The percentage could vary because of age, credited service, or benefit coverage. An increase or decrease in the percentage could not take effect before the expiration of six months or more after the board notified the reporting units of the increase or decrease.
-- A member's compensation, which would be the member's full-time or equated full-time compensation earned in the school fiscal year immediately before the school fiscal year in which the application to purchase and payment for the service were made. The compensation amount could not be less than the highest compensation previously earned by the member.
-- The number of years, including any fraction of a year, of credited service a member elected to purchase up to the maximum allowed.

If the compensation amount used for computing payment exceeded a member's final average compensation determined at the time of retirement, the payment would have to be recomputed using the member's final average compensation, and a refund would have to be made based on the recomputation.

If the compensation amount used for computing payment for purchasing credit for certain service before the bill's effective date exceeded the full-time or equated full-time compensation earned in the school fiscal year used in that computation, the payment for that purchase would have to be recomputed using the greater of either the full-time or equated full-time compensation amount earned for the school fiscal year in which payment was made, or the highest school fiscal year compensation previously earned by the member. A refund would have to be made based on the recomputation, but could be made only to a member, deferred member, or retirant who applied in writing to the retirement board. (The service to which these provisions apply includes teaching at a military base, in another state or territory, at a foreign school for U.S. personnel or dependents, with the job corps, in a trust territory, on an Indian reservation, in a foreign country, or with the merchant marines; employment with a county mental health program; time spent on sabbatical leave; active duty with the armed forces; service with the Red Cross, the Michigan National Guard, the U.S. armed forces reserve, VISTA, or the Peace Corps; time spent on maternity, paternity, or child-rearing leave; employment with a municipal recreation department; and service by a person previously excluded from membership who later joins the system.)

If a member who made a service credit purchase payment died and a retirement allowance beneficiary had not been designated, or if the member withdrew from service before his or her retirement became effective, the payment would have to be refunded to the member or to his or her refund beneficiary upon request.

Allowance Increase

Each retirement allowance that was effective before October 1, 1981, would have to be increased effective January 1, 1990. Generally, the amount of the increase would have to be a percentage of the allowance that would be payable as of 1990 without this increase, depending upon the effective date of retirement. The percentage would range from 1% for retirement between October 1, 1980, and September 30, 1981, to 22% for retirement before October 1, 1960.

In addition, the bill provides for an annual increase, beginning October 1, 1990, for each retirement allowance that was effective on or before January 1, 1987. Generally, the amount of the increase would equal 3% of the allowance that would be payable without this provision. (This would replace the annual 3% increase that would be discontinued under the bill after October 1, 1989.)

Postretirement Service

Under the Act, if a retirant is receiving a retirement allowance other than a disability allowance payable under the Act, on account of age or years of service, and becomes employed by a reporting unit, the retirant is not entitled to a new final average compensation or additional service credit unless five or more years of service credit are performed. The bill would add that a member who had contributed to the MIP would be entitled to a new final average compensation or additional service credit if three or more years of service credit were performed. The bill also would revise the computation of the repayment that a retirant must make before a retirement allowance can be recomputed.

The Act also requires that the retirant's retirement allowance be reduced by the amount that his or her earnings exceed the amount permitted under the Social Security Act without a reduction in benefits. The bill provides that the retirement allowance would have to be reduced by either the Social Security limitation or one-third of the retirant's final average compensation, whichever was less. For the purpose of computing allowable earnings, the final average compensation would have to be increased by 5% for each full year of retirement.

Other Provisions

The bill would add the State Treasurer to the retirement board, which currently consists of the Superintendent of Public Instruction and seven members appointed by the Governor with the advice and consent of the Senate.

A person would be considered a public school employee for purposes of the Act if the person were 1) a member whose reporting unit service consisted of library or museum service and whose employment was terminated because the reporting unit became a participating municipality to a district library agreement; or 2) a former employee of a reporting unit that became a participating municipality to a district library who was a member as a result of that employment. The person would have to be subsequently employed by the district library, however, and the district library board would have to adopt a resolution providing that the district library would make the required payments to the PSERS. The retirement board could grant service credit to the member only if the district library paid the system the amounts required under the Act for employer contributions, a percentage of aggregate annual compensation determined for current service, and a percentage determined for unfunded accrued service.

The Act provides for a 10-year amortization period for the value of benefits attributable to members who retired early when their combined age and length of service totaled at least 80 years. Under the bill, these benefits would be amortized over 50 years, which is the amortization period for other unfunded liabilities.

The bill provides that the reserve for retired benefit payments would be the account from which all retirement allowances and refunds (made when retirement allowance payments terminate before a retirant's accumulated contributions have been paid) would have to be paid. After receiving each annual actuarial valuation, the balance in this reserve would have to be brought into balance with the actuarial present value of retirement allowances to be paid after the end of the fiscal year to retirants and retirement allowance beneficiaries receiving retirement allowances at the end of the fiscal year, by a transfer between the reserve for employer contributions (currently called the pension accumulation fund) and the reserve for retired benefit payments.

The reserve for undistributed investment income would be the account to which would be credited all income from the investment of assets, all gifts and bequests received by the retirement system, and all other money, whose disposition was not specifically provided for, received by the system. The retirement board would have to transfer from this reserve all amounts necessary to credit the interest required under the Act to the reserve for employee contributions, the reserve for employer contributions, the reserve for MIP, the reserve for retired benefit payments, and the reserve for health benefits, and to fund the reserve for administrative expenses (currently called the expense fund).

The Act allows a person to purchase service credit if the person left service as a public school employee, or left out-of-system public education service, for maternity, paternity, or child-rearing purposes. The Act also allows a member to purchase service credit if he or she reduces hours of employment with a reporting unit for maternity, paternity, or child-rearing purposes. The bill would allow the purchase of service credit if a person reduced hours of out-of-system public education service for those purposes and subsequently became a member of the PSERS.

MCL 38.1303 et al. (H.B. 4466)
38.1304 and 38.1391 (H.B. 4433)

FISCAL IMPACT

The State Actuary expects that the bills would result in a net increase in the amount needed to cover the projected benefit obligation. These bills could be revenue neutral if this cost were balanced against the revenue gains realized through the PSERS Board proposed change in the investment rate of return assumptions from 8.0% to 9.8%, compounded annually.

House Bill 4433 would require an increase in the rate used to fund the retirement system to cover dental, vision, and hearing benefits. The increased contribution from the School Aid Fund would be $20,778,000 during the 1989-90 fiscal year if 90% of the insurance premium were paid by the State. This contribution might be expected to increase with the rate of inflation in subsequent years if the State share of the premium (90%) remained unchanged.

ARGUMENTS

Service Credit Purchase

Supporting Argument
Allowing PSERS members to purchase service credit for up to five years, for any reason, would eliminate the proliferation of buy-ins that currently plagues the system, and would provide consistent and equitable treatment of all members regardless of their educational service or employment background. Until the recent past, additional types of service were recognized, in large part, in response to conditions affecting a significant portion of the employee population. For instance, public employment in other states was recognized partly to attract teachers to Michigan following World War II. More recently, credit became available for maternity, paternity, and child-rearing purposes, in recognition of the large number of individuals who interrupt a career to devote time to raising a family. The more recent trend, however, has been to recognize all manner of service, with no regard to its limited application. This has served to whet the appetite of others with career interruptions not directly related to the many types of service for which credit is now available. As a result, there are ever-increasing demands for more and more buy-ins to attempt to provide equity among a dramatically diverse population.

Supporting Argument
The generic buy-in would simplify the administration of service credit purchases, and enable the PSERS to fulfill its mission of providing retirement benefits for public school employees. Currently, this mission is diluted by the effort now required to provide complete information and administer the purchase process. With the addition of each new type of creditable service, the process of educating the membership becomes lengthier and more complex. It is time to concentrate the PSERS's attention and resources on more effective areas, such as preretirement planning. The current trends of retiring earlier and living longer illustrate the need for proper planning. Another example is expanded services to the growing population of retirees. Each change in the system, such as an IRS change, an insurance adjustment, or even a simple address change, adds complexity to the pension payroll process, and the PSERS should have the

resources to provide whatever assistance is needed to allow smooth transitions and facilitate retiree understanding.

Supporting Argument
House Bill 4466 would correct an unfair situation that requires PSERS members to pay for buy-ins based on a formula that reflects a higher salary level than their actual compensation. Most members are unaware of this problem until they actually make the request to purchase service credit, when they cannot retroactively correct the situation.

Opposing Argument
The generic service credit purchase provision could result in more buy-ins and increased processing of payments as a greater number of members purchased additional credit. Further, there would be no specific performance of service required in order to purchase credit; current law at least requires a member to have been employed in some particular way for the purchase of credit.

Response: The bill contains safeguards to prevent this provision from being abused. First, a person could not double-dip by purchasing generic service credit for the years for which credit was purchased under an existing buy-in. And, a person could not retire at an artifically low age (before age 46) by purchasing generic service credit.

Member Investment Plan

Supporting Argument
Mandating the contributory Member Investment Plan for all new employees would bring the PSERS benefit into closer alignment with income needs in retirement. In addition to the basic plan and Social Security benefits, retirees need income to maintain the same standard of living they enjoyed while working, and future retirees will likely need even more additional income because they won't receive Social Security benefits equivalent to those provided to retirees today. Although saving for retirement can be a relatively painless process if started at the beginning of a career, especially if savings are tax-deferred, research reportedly has shown that two-thirds of school employees fail to take advantage of tax-deferred investments, and those who do typically delay participation until their 30s. Participation in the MIP, however, guarantees that a member will achieve a maximum return on his or her investment because of the advantages of participating in the system's professionally managed fund. The member also enjoys security because the MIP is a defined benefit plan whose payout is protected by the State Constitution.

Response: Joining the MIP would not truly be mandatory, since members could drop out during their fourth year of participation.

Supporting Argument
Although school employees share a common identity through their work in education and because they are public sector employees, the present two-tiered retirement plan acts as a divisive force among the membership. The law requires new employees to make a choice at the very time in life and career when retirement planning is of least interest. Often a new employee will elect, or default to, the basic plan through ignorance, indifference, or uncertainty. The employee will then experience frustration and anger when he or she tries to change plans and finds that the decision not to choose the MIP is irreversible.

Supporting Argument
Providing an informational program adequate to meet the needs of 40,000 new employees annually requires an exhaustive effort by both the retirement system and the reporting unit. This effort uses resources that could be applied to other important goals. According to the PSERS, scarce resources in many reporting units result in an inadequate informational effort and uncorrectable errors.

Supporting Argument
Removing the current requirement of adjusting the rate up or down every three years would enhance membership confidence in the plan. Variances in the underlying assumptions, such as investment return and rate of retirement, can increase or decrease the rate in the short run, and needlessly result in alarm and financial inconvenience to the membership.

Opposing Argument
Allowing members to drop out of the MIP after three years would retain the current two-tiered retirement system under which noncontributors evenually will have inadequate benefits to maintain their standard of living. Furthermore, it would cost the State money,

since some members, especially those who are higher paid, would be certain to drop out. Under the bill, a member whose salary was $45,000 would be contributing the current rate of 4%, while a member whose salary was lower would contribute less. Members making over $45,000, however, would contribute more than 4%, and could receive a better return by investing on their own. The bill's contribution rates are predicated on an 85% participation rate; anything less than that would require the State to cover the unfunded liabilities of the plan.

Response: Making the MIP mandatory for three years would address the concern that individuals do not consider retirement when they are first hired, and would give the PSERS three years to educate them about the differences between the plans and the advantages of the MIP. Also, members probably wouldn't miss the contribution if it were automatically deducted from their checks since the beginning, and would be less inclined to drop out than they are now inclined to reject the MIP from the start.

Opposing Argument

When the PSERS became noncontributory to all employees in 1977, it was a collective bargaining issue, and some reporting units gave up pay hikes, or accepted smaller raises, in acknowledgement of this employer contribution. Mandating participation in a contributory retirement plan now would be taking away this negotiated employee benefit.

Response: New members could opt out of MIP participation during their fourth year of contributing.

Opposing Argument

Noncareer employees historically have preferred improvements in pay levels while working over inclusion in the membership of a retirement plan. Other employees would prefer to forego the MIP contribution deduction from their pay despite the earning of market interest rates, the availability of refunds at termination, or the ability to roll over savings into other tax-deferred plans. Members should continue to have the ability to make this decision from the start.

Opposing Argument

Removing the three-year adjustment requirement could be a mistake. If experience proved the underlying assumptions wrong and the revised rates either too high or too low, a change in the rate could occur only with a statutory amendment.

Dental-Hearing-Vision

Supporting Argument

Requiring the PSERS to pay for dental, hearing, and vision benefits would help those who need help the most. Reportedly, the average annual pension received by members is around $7,500, out of which they must pay for dental, hearing, and vision care. While many retirees' income is augmented by Social Security benefits, Michigan public schools did not come under the Social Security program until 1955, and many who retired 25 or 30 years ago are not eligible for those benefits. The costs of dental work, eye examinations and glasses, and treatment for hearing problems unfortunately increase with age. Those who have been retired for some time, and do not have the financial resources to take care of these needs when they arise, often delay seeking medical help or other health care, while the problems worsen.

Retirement Allowance

Supporting Argument

Providing for an increase in the current retirement allowance, while retaining the thirteenth check, would make up for the erosion in retirees' purchasing power due to inflation. An increase based on a percentage of a member's retirement allowance would be beneficial to career employees. These retirees are less advantaged by the thirteenth check, which is of more benefit to those who have been retired the longest and have the lowest allowances. These changes also would give PSERS members parity with members of the State Employees Retirement System.

Other Arguments

Supporting Argument

Liberalizing postretirement earnings restrictions would encourage retirees, especially those who retired at an early age and are not yet receiving Social Security benefits, to accept postretirement work with a reporting unit. Less restrictive limitations also would give school administrators greater flexibility in resolving temporary programmatic needs for experienced personnel, since retirees could be hired while long-term employees were being trained.

Response: Lowering the earnings limitation could increase the amount of work performed by retirees at the expense of younger workers, since employing retirees could reduce payroll costs.

Supporting Argument

House Bill 4466 would allow the purchase of service credit by a person who reduced hours of out-of-system public education service for maternity, paternity, or child-rearing purposes and later became a PSERS member (a buy-in already available to public school employees). This would simplify administration of the system, since different treatment for different groups complicates the informational process and causes confusion among members. Further, the credit for this purpose should apply equally to members whose careers were interrupted regardless of whether they were Michigan residents or out-of-state residents when the absence occurred.

Supporting Argument

House Bill 4466 would modernize and clarify the statute in several ways. Establishing "reserves" instead of "funds" would correspond to modern accounting practices. Redefining "actuarial cost" would establish a common equation to be applied in the calculation of the cost for the purchase of certain types of service credit, and would reflect recent amendments and retirement board action.

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